

## The importance of SME Bank selection criteria-a review through the literature

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**Abstract:** This study analyzes the important role of Small and Medium Sized Enterprises (SME) on the economic growth for both developed and developing countries. Based on the literature review, this study identified very few research work, which were conducted based on SME bank selection. However, bank plays a major role for SME's sustainability and growth. The future scope of this study can identify the important factors for the SME clients in choosing a bank in Bangladesh as no such research has been done. Moreover, we can also compare the important factors that SME clients consider among developed and developing countries.

**Keywords:** Small and Medium- sized enterprises, Bank selection, Bangladesh

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### I. Introduction

Small and Medium-sized companies are playing an important role in both developed and developing countries. SME is considered as "Engine growth" for the developing countries (Floyd and McManus, 2005). By boosting innovation and representing 99 percent of total business activities in the European Union, SME plays a vital for the national economy according to the Commission of the European Communities (2003). Behind the SME's success bank plays very crucial role by providing financing facilities. Many researchers conducted numerous studies regarding diverse topics of SME because of its important role (Berger and Udell, 2006). Javalgi et al. (2011) in their study revealed that few studies have been conducted based on SME business practices in emerging economies. However, very few researchers focused on SMEs bank selection criteria. This topic is imperative as to boost up growth of the SME. Like other developed countries SMEs are playing very vital role in developing countries like Bangladesh. Due to globalization and liberalization Bangladeshi banking sector facing severe competition. To survive in this competitive environment, banks should focus to catch the attention of new clients by identifying what factors are important for them to choose a bank. Most of the researches on bank selection criteria were focused on retail banking. However, banks are playing very important role for the growth of SMEs by arranging overdraft facilities, loan, letter of credits and foreign exchange transactions and sometimes by providing suggestions regarding the client's business. Therefore, for both SME's and bank's perspective it is important to reveal the important factors related to bank selection. In this study we discovered that no such research has been taken place on SME bank selection criteria although the positive relationship between SME and bank is very important to boost up the country's economy.

Therefore, the objectives of the study are,

- (1) To investigate important role of SME
- (2) To investigate why the SME bank selection factors are important based on Bangladeshi Context.

### II. Background Of Sme

According to the European Commission Small and Medium Size Enterprises are one of the key players which are ensuring economic growth, innovation, job creation, and social integration in the European Union (Airaksinen et al., 2015). It is noted that, SMEs account for 99 % of all enterprises in all EU countries and in Norway. They are the source of two third of total employment. SMEs are non-subsidiary and independent firms which consist of maximum 250 employees in European Union. On the other hand, in some countries set the upper limit 200 employees whereas in US SME includes the firms with fewer than 500 employees. In OECD areas SME account for 95% of total enterprises and 60% to 70% jobs (OECD, 2000). In addition, In OECD countries smaller firms are engaged wholesale and retail trade, the hotel and restaurant business, communications and business serv (OECD, 2000) ices, and construction. Arrangement of capital to start up the business is the main constraint for SME growth in both developed and emerging economy.

On the other hand, in ASEAN member countries SMEs representing more than 99% of all enterprises (Harvie, 2015). In many ASEAN member countries SMEs generate 50 to 95% of jobs (ERIA, 2014). 75% of the firms belong to microenterprises, 10-20% small enterprises and less than 5% firms belong to medium sized enterprises. Moreover, 60 to 70% employment generated from SMEs. In ASEAN member countries they are

considered to be important “Entrepreneurial Engine”. The insufficient debt and equity financing is also a vital problem in ASEAN region for SMEs. Due to higher transaction costs, hidden risk, inadequate firm transparency, lack of bank expertise, lack of collateral and proper business plan SME financing is not profitable at all for commercial banks.

In Bangladesh the role of SME is crucial for the nation’s economy. Bangladesh being a developing country achieved strong economic growth by having 7.1 percent growth in 2015-2016. “To sustain growth, Bangladesh needs urgently to implement structural reforms, expand investments in human capital, increase female labor force participation, and raise productivity through increased global value chain integration. Reducing infrastructure gaps and improving the business climate would allow new productive sectors to develop and generate jobs” (World Bank). Every year 2.1 million young people entering into the job markets and to create jobs for those youths Bangladesh should encourage new business opportunities. SMEs can play a vital role to eradicate this employment problems .SMEs constitute about 45 percent of manufacturing value addition, about 90 percent of total industrial units, approximately 80 percent of industrial employment, and about 25 percent of the labor force (Rahman, 2015 ). In Bangladesh around 79,754 Small and medium-sized enterprises established out of 93.6 percent are from small firms and 6.4 percent are from medium firms. SME acts as ‘Employment generating machine’ by ensuring economic growth by lessening the differences between poverty mitigation and income disparity. However, In Bangladesh, the success of SME is dependent on the financing facility. In relation to this, the bank plays a major role for the SME’s start up and growth. To ensure this the bank should play a dynamic role in granting and disbursing SME loan.

### **III. Literature Review**

Many researchers have conducted many studies based on customer’s bank selection criteria. However, the factors were different based on culture and demographic factors.

(Almossawi, 2001) conducted his research based on 1,000 University students in Bahrain who aged 19-24. In his findings, it is noticed that, the most influential factors in choosing bank among University students were convenient ATM locations, availability of ATMs, bank reputation, 24 hours ATM service and parking space near bank. However, the least important factors considered by the same students were recommendation by friends and family, reception received at the bank, employer uses the same bank etc. therefore, from this study it is found that young customers’ prefer technology and convenience while choosing banks. (Bedman, Narteh & Nana, Owusu Frimpong, 2011) did their research based on factors influences Ghanaian students in selecting banks. They surveyed 223 questionnaires where they tried to investigate whether there were any differences in choosing banks between undergraduates and post graduates as well as male and female students. They revealed that, undergraduates gave more importance on minimum banks deposits required by the banks whereas post graduates gave high importance on fast and efficient service by the banks. They also discovered that, the male students preferred delivery of fast and efficient service and ample number of bank branches whereas female students preferred minimum deposits requirements by the banks and efficient service. In Singapore, (Ta and Har, 2000) conducted a survey research among University students and the result discovered based on 176 completed questionnaires. In this study, they found that the most important factors among undergraduates for bank selection were interest rates, service quality and convenient bank location. Charles et al. (2007) did their study based on consumer’s bank selection criteria in three economic and cultural settings. They conducted the survey among college students in USA, Taiwan and Ghana. They found that there were no difference among the important factors related to selecting banks in USA and Taiwan where established open markets exist as well as in Ghana where liberalized developing markets exist.

In USA, Kaufman (1996) investigated the important factors that households prefer in selecting a bank. In this study, he revealed that, convenient location, service quality and length of relationship with banks were the most important factors among households. On the other hand, in Montreal, Canada, Laroche et al. (1986) conducted their survey based on household customers. They found out, the most important factors in choosing banks among households was friendliness of staffs. The other important factors they revealed in their study were efficient staffs, convenient location, waiting time and operating hours.

Kaynak and Kucukemiroglu (1992) conducted their study based on Hong Kong consumer’s preferences in choosing foreign and local banks. Convenient location, parking space in bank premise and financial counseling service were the important factors in choosing banks.

In Poland, Kennington et al. (1996) revealed in their study that the most important factors in choosing banks were reputation, interest rates, service and convenience. They surveyed questionnaires among working population in Poland and they found the results based on 204 completed questionnaires. Due to high rate of inflation in Poland might be the reason behind choosing interest rates as important factor. In Sweden (Zineldin, 1996) based on 214 questionnaires among corporate customers revealed that the five most important factors were trust and confidence, interest rates on loans and other services, customized service, contacts with bank decision maker and speed of service. In Australia, Ross et al. (2001) conducted their research based on

2,500 large and small business firms .they explored, the large firm customers' prefer competitive prices on service more than the other factors. On the other hand, the small firm clients prefer more to build a long term relationship with the banks for customized service and other benefits. They gave least importance on prices on services that bank offers.

Very few studies were conducted based on factors related to SME customer's bank selection. The word "SME" can be defined based on different criteria such as: business size, sales revenue, capital employed and number of employees ( Jobling et al. , 2009). According to (Torrès and Julien, 2005) SMEs mainly characterized as small size business which has centralized management system, simple organizational structure, low-labor specialization, informal information systems and informal approach to strategy. (Welsh and White, 1981) named SME as little big businesses whereas (D'amboise and Muldowney, 1988) characterized SME as gazelles and fuzzy form firms. In Ghana, Narteh(2013 ) based on 503 sample size performed his research on SME bank selection criteria and patronage behavior. In that research, it is identified that most of the SME involved in split banking which enabled them to negotiate the interest rates and other services offered by banks. The study revealed that availability of credit was the most vital factors among SMEs' while choosing banks. Moreover, due to low savings rate and poor income level in Ghana the other important factors were interest rates, flexibility in requirement for collaterals, and availability of loans and overdraft facility. On the other hand, in Pennsylvania Buerger and Ulrich (1986) surveyed 475 small businesses to identify the key factors in choosing banks among SME clients. They discovered, the prices of services were the main important factors while choosing banks. In Libya, Abdulsaleh (2016) conducted the survey based on 200 SMEs to identify important factors in choosing banks. The study revealed that the most important factors considered by the SMEs were competitive prices, availability of loans, relationship with banks and convenient location. In Hong Kong Lam and Burton (2005) found that quality of service was an important element for SME while choosing a bank for transactions and loans. (Kaur, 2015) in his study identified the bank selection criteria of exporting SMEs. The study revealed that prompt service and meeting credit needs were considered very important factors for exporting SMEs in choosing a bank. Trayler et al. (2000) in their study compared the important factors in choosing bank in US and Australia. The study revealed that in both country meeting and accommodating credit needs was the main factors for SMEs in selecting bank. However, he also discovered the other important factors for SMEs in US were the convenient location and variety of products and services whereas in Australia long term relationship with bank and competitive pricing were considered to be other important factors.

#### **IV. Conclusion**

The aim of this study was to analyze the importance of SMEs' bank selection criteria .Based on the literature review, we can conclude that there has been little research conducted based on SMEs-banks' business relationships, especially in emerging economy (Abdulsaleh, 2016). It is found that SME is playing an indispensable role in the growth of nation's economy throughout the world. In Bangladesh there is no such research conducted. By industrialization, economic growth, generating employment and reducing poverty, this sector is playing a vital role in changing the face of the economy in Bangladesh. It generated 1.5 million jobs between 2009 and June 2014 (Rahman, 2015 ).To ensure the nation's growth it is imperative to ensure the growth of SME. The main problem that SMEs are facing is obtaining financing facilities. Bank plays a major role for SMEs' growth and sustainability by sanctioning loans and providing other benefits. To improve bank performance the bank should identify the important factors based on what SME clients choose a bank. Thus, the bank can focus on those factors which will eventually help them to provide better service to SME clients. Hence, it will help the SMEs to survive and succeed. The future scope of this study is to conduct survey on SME bank selection in Bangladesh as this study has not been done yet in Bangladesh.

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